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In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 565

FAIRFIELD STEAMSHIP CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 21–36) is reported at 5 T. C. 566. The opinion of the circuit court of appeals (R. 145–150) is not yet reported.

JURISDICTION

The judgment of the circuit court of appeals was entered on June 21, 1946 (R. 151–152). Taxpayer's petition for rehearing was denied on July 8, 1946 (R. 159). The petition for a writ of certiorari was filed on October 4, 1946. The jurisdiction of this Court is invoked under Sec-

tion 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the court below erred in sustaining the Tax Court's decision that a sale, formally made by taxpayer corporation's sole stockholder, was in substance a sale by taxpayer, the gain from which was includible in taxpayer's gross income as defined by Section 22 (a) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *. (26 U. S. C. 22.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

> SEC. 19.22 (a)–19. *Sale of capital assets by corporation.*—If property is acquired

and later sold for an amount in excess of the cost or other basis, the gain on the sale is income. If, then, a corporation sells its capital assets in whole or in part, it shall include in its gross income for the year in which the sale was made the gain from such sale, computed as provided in sections 111 to 113, inclusive. If the purchaser takes over all the assets and assumes the liabilities, the amount so assumed is part of the selling price.

* * * * *

SEC. 19.22 (a)–21. *Gross income of corporation in liquidation.*—When a corporation is dissolved, its affairs are usually wound up by a receiver or trustees in dissolution. The corporate existence is continued for the purpose of liquidating the assets and paying the debts, and such receiver or trustees stand in the stead of the corporation for such purposes. (See sections 274 and 298.) Any sales of property by them are to be treated as if made by the corporation for the purpose of ascertaining the gain or loss. No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however they may have appreciated or depreciated in value since their acquisition. But see section 44 (d) and section 19.44–5. (See further section 19.52–2.)

STATEMENT

The facts, summarized from the Tax Court's findings (R. 22–32), are as follows:

Atlantic Coast Shipping Company, Inc. (hereafter called "Atlantic") owned all of the stock of taxpayer corporation and 62% of the stock of Cuban Ports Terminal Company (hereafter called "Cuban"). The stock of Atlantic was in turn owned 51% by one Lewis, 39% by Lewis and his attorney as executors of Lewis' father, and 10% by one Dennis. Lewis was president, treasurer, and a director of all three corporations. The offices and books of each corporation were kept at the same address. Taxpayer corporation owned and operated the steamship "Maine", its only other assets consisting of cash and receivables. Atlantic was in the stevedoring business and had never owned any ships. Cuban's only substantial asset was a wharf at Havana (R. 22–23, 29).

Early in 1940, the stockholders of Atlantic agreed upon a tax-saving plan which contemplated the following steps: (1) liquidation of taxpayer corporation; (2) sale of the "Maine" by Atlantic at a profit, as soon as title to the ship was passed to it upon liquidation; (3) disposition at a loss of the wharf owned by Cuban, resulting in worthlessness of Cuban's stock held by Atlantic; (4) offset by Atlantic of the expected gain from the sale of the "Maine" against the ex-

pected worthless stock loss; and (5) liquidation of Atlantic (R. 23–24). Pursuant to this plan and on September 9, 1940, Lewis (acting through one Pendleton) employed one Lambert, a ship broker, to solicit purchase offers for the "Maine". Between September 9 and September 18, Lambert negotiated with British interests and procured two successive offers of purchase. Lewis rejected both, requesting a better price. Lambert renewed his negotiations and on September 18 procured a third and better offer at $50 per deadweight ton. Lewis advised him that this latest offer was acceptable, but that the sale would not be consummated until title to the "Maine" was first transferred from taxpayer corporation to Atlantic. Lambert then advised the purchaser that its latest offer was accepted and that delivery was expected in early October (R. 24–27).

The following day, September 19, a special meeting of Atlantic's stockholders was held at which it was resolved that Atlantic surrender taxpayer's stock in exchange for all of taxpayer's assets, including the "Maine". This meeting was recessed and special meetings of taxpayer's stockholder and directors were then held at which it was resolved that Lewis be authorized to take all steps necessary to dissolve taxpayer. Upon conclusion of these meetings and on the same afternoon, the recessed meeting of Atlantic's stockholders was reconvened, and it was resolved that

Lewis be "authorized to negotiate a contract for the sale of the ss 'Maine', to a prospective British purchaser, at a purchase price of $50. per deadweight ton", and to execute all necessary documents to carry out the sale (R. 27–29).

On September 23, Lewis, as president of taxpayer, executed a bill of sale of the "Maine" to Atlantic, which was recorded September 26. On September 30, Lewis, as president of Atlantic, executed a contract for the sale of the "Maine" to the purchaser. The written contract of sale embodied the same conditions as those specified in connection with the original offer. Delivery was made on October 3, and Lambert received a commission, paid by Atlantic, for procuring an acceptable offer. On December 27, taxpayer transferred to Atlantic the balance of its assets, including $107,855.07 in cash, in exchange for its outstanding stock. The wharf owned by Cuban was sold at a loss (R. 29–31).

In its 1940 income tax return, taxpayer did not report any gain from the sale of the "Maine". In its return, Atlantic reported a long-term capital gain of $331,726.85 from the sale of the "Maine", and a long-term capital loss of $390,000 based upon the alleged worthlessness of Cuban's stock, or a net long-term capital loss of $58,273.15 (R. 31–32). The Tax Court sustained the Commissioner's determination that the sale was in substance that of taxpayer and that the gain was

therefore attributable to it, not to Atlantic (R. 32–36). The circuit court of appeals affirmed (R. 146–150), and denied taxpayer's petition for rehearing (R. 159).

ARGUMENT

This case is controlled by the decision of this Court in *Commissioner* v. *Court Holding Co.*, 324 U. S. 331. There is no occasion for further review.

1. The question here is the same as in *Commissioner* v. *Court Holding Co., supra,* namely, whether the gain from a post-liquidation sale formally executed by a controlling stockholder is attributable to the liquidating corporation or to the stockholder. The long-standing regulations under Section 22 (a) of the Internal Revenue Code, *supra,* provide that if a corporation sells appreciated assets it is taxable on the resultant gain, but that the corporation realizes no taxable gain if it distributes the assets in kind in partial or complete liquidation. Sections 19.22 (a)–19 and 19.22 (a)–21 of Treasury Regulations 103, *supra.* In relieving the corporation of tax liability upon a liquidation distribution of appreciated assets, the statute is patently aimed at genuine distributions in liquidation; it was not intended to embrace one which, though technically perfect, is but a transitory tax-avoidance step in the passage of ownership from the corporation to a

purchaser already found upon terms of sale already agreed upon. In the *Court Holding* case, this Court held (p. 334) that the tax consequences flow from the "substance" of the transaction "viewed as a whole", not solely from the means employed to transfer title to the purchaser; and that whether the sale is in substance that of the controlling stockholder or the corporation presents a question for the Tax Court, whose inference is entitled to finality if supported by evidence. The decisions of the circuit courts of appeals are to the same effect.[1]

Applying the principles of the *Court Holding* case, the Tax Court viewed the instant transaction in its entirety and concluded (R. 32–35) that what substantially occurred was a sale of the steamship "Maine" by taxpayer to a third party via its sole stockholder, Atlantic, not a true liquidation distribution of the vessel and independent sale by Atlantic. The facts found by the

[1] *Mearer Steel Barrel Co.* v. *Commissioner*, 144 F. 2d 282 (C. C. A. 3d), certiorari denied, 324 U. S. 860; *Embry Realty Co.* v. *Glenn*, 116 F. 2d 682 (C. C. A. 6th); *S. A. MacQueen Co.* v. *Commissioner*, 67 F. 2d 857 (C. C. A. 3d); *Trafford Oil & Gas Co.* v. *Commissioner*, 78 F. 2d 814 (C. C. A. 3d), certiorari denied, 296 U. S. 630; *Liberty Service Corp.* v. *Commissioner*, 77 F. 2d 94 (C. C. A. 3d); *Nace Realty Co.* v. *Commissioner*, 28 B. T. A. 467, affirmed *per curiam* April 13, 1935 (C. C. A. 6th); *Boggs-Burnam & Co.* v. *Commissioner*, 26 B. T. A. 988, affirmed, 71 F. 2d 999 (C. C. A. 6th); cf. *Trippett* v. *Commissioner*, 118 F. 2d 764 (C. C. A. 5th), certiorari denied, 314 U. S. 644; *Commissioner* v. *Falcon Co.*, 127 F. 2d 277 (C. C. A. 5th).

Tax Court, and accepted by taxpayer (Pet. 15), unquestionably warrant that inference. Here, as in the *Court Holding* case, the so-called liquidation distribution was effected and the sale consummated by the stockholder only after the purchaser had been solicited and all the material terms of sale had been negotiated. Atlantic's sale was not a new and separate transaction, unrelated to the prior negotiations, but the culminating step of a single business deal. Indeed, the only purchase offer which Atlantic accepted was that submitted and found acceptable while taxpayer owned the vessel, and the formal sale contract which Atlantic executed embodied substantially the same terms of sale theretofore negotiated (R. 24–30, 33–34). Again here, as in the *Court Holding* case, the intervening liquidating distribution served no business purpose but only that of tax avoidance. It was planned from the outset that the gain from the sale would be reported by Atlantic, and offset by its deduction of an alleged worthless stock loss (R. 23–24, 36). Not a single practical result could possibly have been achieved by the circuitous routing of title to the purchaser through Atlantic which would not also have been reached had taxpayer simply and directly consummated the sale itself, collected the purchase price, and distributed the cash proceeds to Atlantic in liquidation. Atlantic did not take title to the "Maine" in order to hold or use the vessel as its own, for ad-

mittedly it immediately re-transferred the title to the purchaser and itself liquidated. Nor could the mechanics employed have facilitated Atlantic's own liquidation, for, had taxpayer directly consummated the sale, Atlantic would have ended up with cash for distribution to its own stockholders—precisely as it did by substituting itself as the vendor.[2]

Affirmance of the Tax Court's decision by the court below was plainly in keeping with established principles, reiterated by this Court in the *Court Holding* case, governing the scope of judicial review of Tax Court decisions.

2. It is true, as taxpayer asserts (Pet. 15–16), that the court below purported to distinguish the *Court Holding* case from this one. It did so on the ground that there the intervening liquidation distribution was contrived as a tax-saving step after the sale negotiations had been completed, whereas here that step was planned from the very start of the negotiations (R. 148). This distinction is one of factual pattern, however,

[2] The unreality of the so-called liquidation distribution is emphasized by the fact that, although taxpayer resolved on September 19 to transfer "all of its assets" to Atlantic "in exchange for all of the outstanding stock" of taxpayer (R. 28, 35), only the "Maine" was transferred to Atlantic on September 23 (R. 29), ostensibly to enable the latter to execute the contract of sale on September 30. Taxpayer's remaining assets (including a substantial amount of cash) were not transferred to Atlantic, nor was taxpayer's stock canceled, until the close of the taxable year (R. 31).

rather than of applicable principles. The "substance" of the transaction depends of course on what was done, not on when the plan for its accomplishment was conceived; nothing in this Court's opinion in the *Court Holding* case or elsewhere warrants the assumption that what is otherwise a single transaction for tax purposes is to be subdivided into its component steps because those steps were contemplated long in advance of their execution. Since "the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant" (*Commissioner* v. *Court Holding Co.,* 324 U. S. at 334), the existence of a preconceived tax-saving plan rather lends cumulative support to the Tax Court's inference that the negotiations for the sale, the transfer of title to the stockholder by way of the so-called liquidation distribution, and the retransfer of title by the stockholder to the purchaser were not isolated transactions, but were interrelated parts of one transaction. Cf. *Commissioner* v. *Tower,* 327 U. S. 280; *Gregory* v. *Helvering,* 293 U. S. 465; *Meurer Steel Barrel Co.* v. *Commissioner,* 144 F. 2d 282 (C. C. A. 3d), certiorari denied, 324 U. S. 860. The court below tacitly acknowledged that the distinction it drew was not a vital one by proceeding to hold (R. 148) that the Tax Court's decision was "right, regardless of whether the shareholders of the Atlantic Com-

pany always intended that that company should sell the ship". And that the rationale of its opinion is essentially, though not expressly, the same as that of this Court in the *Court Holding* case is apparent from its assimilation of this case with the *Gregory* case, upon which this Court relied in the *Court Holding* case.[3]

3. Section 112 (b) (6) of the Internal Revenue Code, with whose provisions taxpayer contends it complied (Pet. 10, 14–19), has no bearing on whether the gain from the sale is includible in its gross income under Section 22 (a). Section 112 (b) (6) deals exclusively with the tax liability of the *distributee stockholder* in certain cases of complete liquidation of a subsidiary by a parent corporation, and represents an exception to the general rule, contained in Section 115 (c), governing the tax consequences to a recipient stockholder upon a liquidation distribution. See Section 19.112 (b) (6)–1 of Treasury Regulations 103. In considering the applicability of Section 112 (b) (6), the court below perhaps attached

[3] Both the reorganization provisions involved in the *Gregory* case and the liquidation-in-kind provisions here involved are aimed at relief from taxation. In both instances no gain or loss is recognized. In neither case does a ritualistic compliance with the literal terms of the relief provisions suffice to give the taxpayer tax advantages that were plainly intended for others. To grant the relief in this case would pervert the purpose of the liquidation-in-kind provisions in the same manner that the taxpayer unsuccessfully sought in the *Gregory* case to misuse the reorganization provisions.

undue significance to the circumstance that the transferee stockholder in this case was another corporation rather than (as in the *Court Holding* case) an individual. Irrespective of whether the recipient stockholder is an individual subject to tax on the distribution under Section 115 (c) or a corporation qualifying for exemption under Section 112 (b) (6), the tax consequence to the *liquidating corporation* in cases like the present turns on whether the liquidation distribution is a real one falling within the purview of the provisions of Section 19.22 (a)–21 of Treasury Regulations 103, *supra,* or an artificial one designed to insulate the corporation from realization of gain on a sale of its assets. This is the transcendent question to which the Tax Court addressed itself, and which it decided adversely to taxpayer. Since its determination has solid evidentiary support, affirmance of its decision by the court below was clearly correct. That in sustaining the Tax Court the court below may have strayed beyond the issue furnishes no basis for further review.[4]

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[4] In the addendum to its opinion (R. 149–150) the court below properly shifted its attention from Section 112 (b) (6) to Section 19.22 (a)–21 of the Regulations, applicable to Section 22 (a). Taxpayer's contention (pet. 19–21) that it was error to consider this regulation is untenable. *Commissioner* v. *Court Holding Co.*, 324 U. S. at 332, note 3; *Hellebush* v. *Commissioner*, 65 F. 2d 902 (C. C. A. 6th); *Tazewell Electric Light & Power Co.* v. *Strother*, 84 F. 2d 327 (C. C. A. 4th); *Northwest Utilities Securities Corp.* v. *Helvering*, 67

CONCLUSION

Taxpayer does not and cannot assert conflict with any decision of this Court or of any circuit court of appeals. To permit the tax consequences here to turn on the considerations stressed by taxpayer would sanction the very type of formalism which this Court has repeatedly refused to recognize as effectual to alter tax liability. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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OCTOBER 1946.

F. 2d 619 (C. C. A. 8th), certiorari denied, 291 U. S. 684; *Taylor Oil & Gas Co.* v. *Commissioner*, 47 F. 2d 108 (C. C. A. 5th), certiorari denied, 283 U. S. 862; *First Nat. Bank of Greeley, Colo.* v. *United States*, 86 F. 2d 938 (C. C. A. 10th). Since the record does not disclose whether taxpayer had satisfied its debts before making the so-called liquidation distribution, its stockholder must in any event be deemed to have acted as trustee in dissolution within the meaning of the regulation, and not in its own behalf, in transferring taxpayer's principal asset to a purchaser and receiving the proceeds. This is consonant with the familiar equity principle that dominant stockholders, by virtue of their fiduciary position, may not deal with the corporate assets as their own. *Pepper* v. *Litton*, 308 U. S. 295, 306–307. Cf. *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44, 48–49.

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